COUNCILMEMBER CARL DEMAIO

FIFTH DISTRICT

CITY OF SAN DIEGO

MEMORANDUM

DATE: April 23, 2009

TO: Jeff Graham, Vice President - Redevelopment, CCDC

VIA: Councilmember Carl DeMaio Carl DeMaio

FROM: Tom Aaron, Budget and Policy Advisor, Council District 5

RE: Updated JLL Civic Center Redevelopment Financial Models

As you know, our office has been vocal in raising concerns regarding the proposed Civic Center redevelopment project. Regardless of our policy position, however, we feel it is essential that both stakeholders and decision-makers are presented with sufficiently vetted and impartial analysis.

When the proposal for a new City Hall was first revealed, our office raised several concerns with the original financial analysis – concerns which were ultimately validated by the recent peer review.

Now, our office would like to raise additional concerns regarding assumptions used in the latest financial modeling. In particular, these concerns call into question some of the "savings" claimed in the presentation materials. As such, we respectfully request a written response addressing these concerns.

Furthermore, it has come to our attention that in addition to today's scheduled public hearing, CCDC representatives will be taking part in stakeholder outreach efforts on the updated financial projections as early as this week. Once the questions and concerns expressed below are adequately addressed, we ask that outreach efforts reflect necessary edits as soon as possible.

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Annual Financial Projections:

On pages 18 – 21 of the "Updated Financial Evaluation Briefing" prepared and presented by JLL, annual expense comparisons between development and the Hold Steady scenario are provided. Examining the calculation of "Net Costs" between development and Hold Steady reveals that revenue offsets, particularly "Master Lease Income" are applied to the development proposal. This yields annual net costs of approximately $25 - $30 million under the development scenario, depending on whether Alternative B or D is used. Importantly, our office has been informed that the development alternatives assume 193,000 square feet of excess space in 2013 to create cost mitigating revenue for the project.

In comparison, in the Hold Steady scenario, a new City Hall is occupied in Year 10 (2018), with the City experiencing annual net costs of approximately $40 million. This is significantly greater than the annual net costs of $25-$30 million attributed to the Gerding Development Alternatives discussed above.

As CCDC has indicated to our office, only 40,000 square feet of excess space has been assumed for the new City Hall in the Hold Steady scenario (compared to 193,000 square feet mentioned above). As a result, the available amount of cost mitigating revenue is significantly less in the Hold Steady scenario, which increases its costs, and amplifies the value of "15 Year Savings" provided in the JLL presentation.

Given the uncertainty of the specific aspects of future proposals relating to cost mitigating revenue, the assumptions used in the updated models where a smaller, "build-to-suit," development with far less excess space provide a useful depiction of cost comparisons over the 15 year term. However, only recognizing this approach ignores the potential for the City to receive a similar development proposal several years down the line. Furthermore, assuming such a drastically lower amount of excess space in the Hold Steady City Hall significantly increases the amount of 15 year savings.

The table below adjusts the 15 year savings figures provided in each scenario by $34.7 million. This is equivalent to the sum of Master Lease Income in the years 2013 – 2017 attributed to the Gerding scenarios.

Proposal Comparison to "Hold Steady"				
	"B" Full Development		"D" Phase 1 Only	
	Minimum	Maximum	Minimum	Maximum
10 - Year	($21.9)	($8.5)	($26.2)	($12.8)
15 – Year (JLL Presentation)	$44.8	$58.2	$26.9	$40.3
15 - Year Adjusted	$10.1	$23.5	($7.8)	$5.6

Note: Given that 40,000 square feet of revenue offsets are already included in the Hold Steady scenario, it may be prudent to use an adjustment of offsetting revenue for only the remaining square foot variance (153,000 square feet). If appropriate, this would result in an adjustment of savings/costs by less than the $34.7 million amount used in the table above, but would still change the 15 year cost savings significantly.

As the table shows, adjusting the 15 year scenario by the full $34.7 million of Master Lease offsets changes the conclusions of 15 year cost savings. Upon adjustment, the new range provides for savings of $23.5 million in at best, but a cost increase over 15 years of $7.8 million at worst. By comparison, the JLL presentation provides for a range of savings from $26.9 million to $58.2 million over a 15 year period.

Unless the interpretation provided above is shown to be inaccurate, we request that the presentation include further sensitivity analysis, providing annual cash flow projections for the Hold Steady scenario in the event that a similar development proposal is received for the Hold Steady City Hall. The conclusions regarding 15 year cost savings should also be adjusted accordingly, and presented as a potential range.

Minimum and Maximum Capital Expenditures Analysis:

On page 15 of the JLL report, values are provided for minimum and maximum capital expenditures under the Gerding development alternatives and the Hold Steady scenario. While the application of this approach to the financial modeling is commendable, the Gerding "Minimum" value of $0 appears to unfairly benefit development. As recommended by the Ernst & Young third party review, The Hold Steady option requires "an emergency building renovation fund for building repairs on owned facilities" of $1 million per year. This fund is for "unexpected capital improvement needs as a result of deteriorating conditions" on City buildings.

However, the City will continue to occupy the current buildings under the Gerding proposal in the short term as well. It appears unbalanced to assume that for the short-term (5 years), the emergency reserve would not be required under the development scenario.

While expending funds on improving or maintaining any building in its last years of life certainly is undesirable, the emergency fund is recommended to maintain functionality. Since functionality must be maintained in the short term under any scenario, should the Gerding 5 year "Minimum" capital expenditure analysis at least include an emergency reserve for functionality similar to Hold Steady?

Ensuring a balanced and accurate analysis of the City's short and long term options for office space moving forward is a high priority for our office. To this end, we respectfully request that the above expressed concerns are addressed - and if appropriate, incorporated into the overall conclusion of the report - prior to further claims of "cost savings" over a 15 year period.

CC: Honorable Mayor Jerry Sanders
Honorable City Councilmembers
Andrea Tevlin, Independent Budget Analyst
Fred Maas, Chair, CCDC Board of Directors